**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**WASHINGTON, D.C. 20554**

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| In the Matter of | ) | |
| | ) | |
| Inquiry on Rules Affecting | ) | MB Docket No. 05-28 |
| Competition in the Television | ) | |
| Marketplace | ) | |
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# SUPPLEMENTAL SUBMISSION OF JOINT CABLE COMMENTERS


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May 23, 2005

## SUMMARY

Nothing in the broadcast filings refutes the central points made by the Joint Cable Commenters. First, retransmission consent has driven the increased size and price of the expanded basic tier of cable television by giving broadcasters the power to leverage a public asset -- free spectrum provided by the government -- to obtain revenues from cable consumers. In doing so, retransmission consent has jump-started Big Four vertical integration with Hollywood. Broadcasters have unquestionably become the dominant suppliers of cable programming.

In the meantime, broadcasters offer no evidence that retransmission consent has improved -- or even preserved -- the competitive strength of free, local over-the-air broadcasting as an alternative to multichannel television. Broadcasters are reduced to arguing that over-the-air and multichannel programming assets are interchangeable on their balance sheets. How this is consistent with Congressional intent they fail to explain.

There is no question that consumers pay higher prices for cable than they otherwise would absent retransmission consent. To be sure, the expanded basic tier provides a strong value to consumers. But the use of retransmission consent to launch, and enhance distribution of, broadcaster-owned channels (that the Big Four insist on including on the most popular service tier) has been a major factor in shaping the price and composition of the package. The gap between Congressional expectations in 1992 and marketplace reality in 2005 could hardly be wider.

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## INTRODUCTION

As detailed more fully below, and in the attached submission from Professor William Rogerson entitled "A Further Economic Analysis of the Social Cost of Retransmission Consent Regulations,"[1] the reply comments offered by broadcast interests in this proceeding fail to seriously dispute the central points made in our initial submission. Those points were:

(1) Retransmission consent has driven the increased size and price of the expanded basic tier of cable television, as it has spurred the broadcast network companies' ever-increasing domination of expanded basic programming. In 1992, using the top 5 television markets as an illustration, ABC's ESPN was the only broadcaster-affiliated cable network on an average expanded basic tier of 24 channels. Today, on a typical expanded basic tier of 41 channels, half are broadcaster-affiliated.[2]

(2) Retransmission consent has contributed to the vertical integration of broadcast network companies with Hollywood studios. In 1992, only one network (Fox) was vertically integrated with a studio, although Fox was not then a cable/satellite programmer. Today the remaining three have either acquired (NBC/GE) or been acquired (CBS, ABC) by a major studio, and all are major cable/satellite programmers.

(3) Retransmission consent has not improved, or even preserved, the strength of free local over-the-air broadcasting as an alternative to multichannel television; indeed it has contributed mightily to a world in which the

[1] *See* Exhibit A ("Rogerson Reply"). Professor Rogerson responds directly to the economic studies submitted by the broadcasters in this Docket.

[2] *See* Joint Cable Comments at 42, 44, Table C and E.

overwhelming majority of consumers feel the need to have both cable/satellite channels and local television. Since enactment of retransmission consent, the proportion of American homes relying solely on broadcast television has shrunk by half, to 20 percent, and continues to fall.

(4) The power given to broadcasters by retransmission consent was increased by the emergence of DBS as a full-fledged competitor, and it will be further increased as telephone companies and others enter the marketplace. Although the broadcast networks' share of viewing has fallen, their status as "must have" programming is unchanged. Their continuing power can be seen in the advertising marketplace, where network broadcasting revenues have grown even as viewership has declined.

Unable to refute the arguments of the Joint Cable Commenters, the network broadcasters resort to mischaracterizing both our case and the role of economic regulation in television programming.

The broadcasters' reply comments in this proceeding go to great lengths to portray our initial submission as suggesting that broadcast network companies have improperly misused or subverted retransmission consent in underhanded ways.[3] Instead, our initial comments made the case that, in the marketplace, broadcasters and cable operators responded to the new incentive of retransmission consent in ways that no one anticipated when retransmission consent was adopted in 1992. That includes the transformation of the companies that owned broadcast networks into media behemoths that dominate both network broadcasting and its cable/satellite competition.

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[3] *See, e.g.*, NAB Reply Comments at 5 ("The primary focus of the MVPDs wrath is directed to retransmission consent"); *id.* at 9 (MVPDs claim that "broadcasters' bundling of their retransmission consent with non-broadcast programming . . . [is] evil incarnate"); *id.* at 10 ("Professor Rogerson assert[s] that broadcasters' bundling of retransmission consent with non-broadcast programming . . . is part of a sinister plot"); Fox Reply Comments at 10 (denying that "broadcasters entered the MVPD market with bad intentions for over-the-air broadcasting").

And the network broadcasters are equally far from straightforward when they argue that unrestricted retransmission consent is simply in the order of things – that like all programmers they should be unfettered in their power to withhold their products as they choose. The programming marketplace is far from unfettered. Broadcasters have always received their spectrum subject to public interest requirements, and continue to do so. Until 1992, those requirements included the requirement to serve the public without charge. Even today broadcasters are not allowed to charge the 20 percent of Americans who receive their signals over the air. Nor are network broadcasters alone among programmers in being subject to regulation.

Both MVPD program networks affiliated with cable systems and cable systems affiliated with MVPD program networks are subject to antidiscrimination and program access requirements which regulate wholesale pricing and availability. Time Warner is further prohibited from tying HBO with its other MVPD program networks in carriage negotiations. The News Corp./DirecTV merger approval restricted the Fox regional sports networks, as well as DirecTV and Fox Broadcasting, with respect to their dealings in the wholesale programming marketplace. Cable operators and DBS systems are required by statute to carry broadcasters on the tier of service received by every one of their customers. If a broadcaster invokes must-carry, DBS and cable must carry them pursuant to regulation, without any private contractual relationship at all. Given the wide range of existing restrictions on the programming marketplace, looking at how programmers otherwise are treated provides no basis at all for failing to examine the continued utility of retransmission consent or the need for reform.

Nor are broadcasters' efforts to minimize the power of retransmission consent in this proceeding consistent with their public positions taken elsewhere. For example, last month, Viacom co-president and co-COO Tom Freston told financial analysts that "Retrans has been a great value to MTV Networks over the past five years since we merged with CBS, as we've been able to mop up all kinds of analog and digital space . . . ."[4] Similarly, George Bodenheimer of ABC/Disney last month likened his company's approach to retransmission consent to "a service organization to the cable operator":

> [W]e haven't linked in any way retransmission consent to any one particular service What we try to do is Sean and Ben work with the cable operator on what they're interested in. May be Soap, maybe Toon, maybe ESPNU. I mean that's part of the beauty of the organization we've set up here. It's really a service organization to the cable operator. They may have an interest in a particular service, or they might be in a region of the country . . . <u>So we're open to a discussion where our company receives compensation for retransmission consent in a variety of ways</u>."[5]

That "variety of ways" has added significantly to size and cost of the expanded basic tier.

As noted in our initial comments, the power of retransmission consent was greatly increased with the emergence of DBS competition. It will be strengthened further as telephone companies and others join the competitive fray. It is therefore altogether appropriate that as part of this proceeding the Commission examine the impact of retransmission consent on consumer welfare in the increasingly competitive MVPD marketplace.

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[4] "CBS Eyes Retrans After Viacom Split," *Multichannel News*, April 19, 2005.

[5] "Disney TV's Anne and George Show," *Multichannel News*, April 4, 2005 (*emphasis supplied*). Whatever else might be said about the purpose and effect of retransmission consent, Congress clearly had no intention of enacting the policy in order to help MTV or create a "service organization" for cable operators. *Id.*

## I. THE PRINCIPAL MARKETPLACE EFFECT OF RETRANSMISSION CONSENT HAS BEEN TO FACILITATE BROADCASTER ENTRY INTO, AND DOMINANCE OF, MVPD PROGRAMMING

In their filings, broadcasters do not deny that retransmission consent has helped to fuel their entry into cable. Instead, they argue (i) that cable was complicit in this outcome; (ii) that broadcasters are not a substantial player in the MVPD programming marketplace; and (iii) that such an outcome is not the result of market power or undue leverage. The first point is a misleading distraction, and the second two are flatly incorrect.

### A. Broadcasters' Attempts to Blame Cable for the Effects of Retransmission Consent Constitute the Most Obvious Form of "Red Herring"

Retransmission consent agreements are just that -- contractual arrangements between two parties -- one a cable operator and the other a broadcaster. If "blame" is the issue -- which we do not believe -- both are plainly responsible. [6] But we do not argue that either acted inappropriately in response to the broadcasters' exercise of their new retransmission consent power. Faced with a choice between charging their customers

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[6] In fact, broadcast officials themselves do not universally hold the view that the Big Four were unwilling conscripts in the use of cable carriage as currency in retransmission consent negotiations. In 2001, Alan Frank, current chairman of the Network Affiliated Stations Alliance, described the evolution of retransmission consent as follows: "The second revenue stream is a significant issue - from cable, satellite, wherever. The potential was created by Congress in 1992 - then ABC decided to tell the cable networks that they could not pay them for their stations but instead pay them for ESPN. That set a precedent." "The Evangelists: Alan Frank, Preaching the Gospel of Local TV," *Electronic Media*, April 23, 2001. *See also* "Affiliates Question ABC deal," *Electronic Media*, July 19, 1993 ("ABC affiliates . . . said their positions at the bargaining table will be hurt by Hearst and ABC's acceptance of a rollout of ESPN2 in lieu of straight cash deals. 'Here you have one of the industry's leaders saying, "We're going to settle for less than cash,"' said Jim Matthews, president and general manager of WJKS-TV, an ABC affiliate in Jacksonsville, Fla. . . . One networks executive who did not want to be identified said, "I think they've screwed their affiliates.'").

more for the same thing or obtaining a number of new, high quality networks for their customers, cable operators chose the latter. Given the opportunity to "become the opposition, "'the network broadcasting companies did just that, and reshaped and recombined themselves to dominate MVPD programming--and Hollywood to boot. Our point is that this course of events has had costs and benefits that were not anticipated at the time retransmission consent was adopted. Now that we have more than a decade of experience, it is time to examine the past and likely future impacts of retransmission consent, and consider what changes may be appropriate going forward.

### B. Measured Against Any Meaningful Benchmark, the Big Four Have Become the Dominant Players in the MVPD Programming Marketplace Since Adoption of Retransmission Consent

Several broadcasters attempt to downplay their role in cable programming by asserting that they own -- individually and collectively -- a relatively small percentage of the total number of cable networks available for distribution by MVPDs.[7] Revenues, subscribers, and viewership are the principal yardsticks of clout in the cable programming marketplace, and the broadcaster-affiliated cable networks are the leaders in those categories. The Big Four networks account for 56.5 percent of all MVPD program network revenues, own 12 of the top 20 MVPD program networks (measured by subscriber count), and 12 of the top 15 MVPD program networks (measured on the basis of prime-time ratings).[8]

[7] *See, e.g.,* Viacom Reply Comments at 13 (broadcast networks have ownership interests in only 23 percent of existing satellite-delivered national program networks).

[8] *See* "The Social Cost of Retransmission Consent Regulations," by William P. Rogerson at Table 2 ("Rogerson"), attached to Joint Cable Comments; *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eleventh Annual Report*, MB Docket No. 04-227 (rel. Feb. 4, 2005), at Tables C-6 and C-7.

The broadcasters' effort to diminish their significance in the marketplace by playing "numbers games" regarding the total number of MVPD program networks available on the marketplace is unavailing, since a substantial majority of those networks do not even have the minimum number of subscribers identified by the FCC as being necessary for viability. The FCC has stated that a MVPD program network needs a minimum of 20 million subscribers in order to be viable.[9] Only 78 of the 388 MVPD program networks available for MVPD distribution meet this minimum threshold. Of those 78, nearly half (47.4 percent) are owned by broadcasters. Viacom itself has stated that an MVPD program network needs 50 million subscribers in order to have a viable advertising revenue stream;[10] only 28 MVPD program networks meet the Viacom minimum threshold, and over half of those networks are owned by broadcasters.

Viacom suggests that retransmission consent's role in facilitating broadcasters' entry into the MVPD program network market is exaggerated because many of the broadcast-owned networks were acquired rather than launched. The distinction is of no moment. Broadcasters' acquisitions of MVPD program networks were fueled by the expectation of using retransmission consent to exploit those assets more effectively, as Viacom officials themselves have expressly acknowledged.[11]

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[9] *Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992*, 14 FCC Rcd 19098, 19115 (1999).

[10] Comments of Viacom, in MB Docket No. 04-207, *A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite*, at 8-9 (Jul. 15, 2004).

[11] "CBS Eyes Retrans After Viacom Split," *Multichannel News*, April 19, 2005 (quoting Viacom's Tom Freston: "Retrans has been a great value to MTV Networks over the past five years since we merged with CBS, as we've been able to mop up all kinds of analog and digital space"). *See also* Joint Cable Comments at 21.

### C. Retransmission Consent Provides Network Broadcasters with Leverage that Bolsters Their Ability to Launch and Strengthen their Affiliated MVPD Program Networks

The Network Affiliates and other broadcasters attempt to downplay the market power of the broadcast networks and the leverage that power affords them in retransmission consent negotiations.[12] The Network Affiliates state that the FCC has never recognized "any such thing as 'must-have' programming" and that such a notion is "absurd."[13] This is flatly wrong. The Commission itself has expressly used the term "must have" programming,[14] and has observed that MVPDs can be harmed if they lack access to programming for "which there is no readily acceptable substitute."[15]

Notwithstanding the Network Affiliates' bald assertion to the contrary, broadcast network executives themselves appear to recognize that there is such a thing as must-have programming. Disney's Michael Eisner has stated that, "ABC offers the highly valued programming that cable operators need, i.e., retransmission consent,"[16] and the

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[12] *See, e.g.*, Network Affiliates Reply Comments at 12-15; NBC Reply Comments at 7-9; Viacom Reply Comments at 6-9.

[13] Network Affiliates Reply Comments at 12.

[14] *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution, Sunset of Exclusive Contract Prohibition, Report and Order*, 17 FCC Rcd 12124, 12139 ¶ 34 (2002) ("*Program Access Sunset Order*"); *id.* at 12145 ¶ 47.

[15] *Id.* at 12148 ¶ 54. The Network Affiliates' suggestion that MVPD "program exclusivity agreements with their program suppliers are not regulated at all by the Commission," is also wrong. Network Affiliates Reply Comments at 18. The Commission's program access rules regulate exclusive agreements between cable operators and vertically-integrated cable programmers. *See* 47 U.S.C. § 548; 47 C.F.R. § 1001.

[16] *Walt Disney at Citicorp Smith Barney Entertainment, Media and Telecom Conference,* FD Wire, Jan. 6, 2004.

company's President, Robert Iger, has specifically characterized his company's programming as "must have":

> [A] distribution platform cannot afford to be without best brands. . . . [A] distribution platform has to deliver to its customers what they most want, and you're talking about CBS, and Nickelodeon, and MTV, and the Disney channel, and you could name many of them. Each of the content companies possesses a nice collection of so-called best brands or must-haves.[17]

Likewise, Viacom's former President Mel Karmazin might take issue with the Network Affiliates' view:

> [W]e are an important provider of content to satellite and cable. We believe that we are big enough to [where], if somebody and I certainly know News Corp. wouldn't, but if somebody were to do something stupid, they would have great consequences for doing that with a company the size of Viacom. Obviously, we have retransmission consent, which is something that we think DirecTV or any cable company is going to want to offer their customers, you know, available. So they want to have CBS and that gives us a good seat at the table.[18]

The Commission itself specifically has observed that the "signals of local television broadcast signals are without close substitutes" and that due to the "extremely limited availability of new television broadcast licenses, entry into this segment of the video programming market is highly restricted."[19] Contrary to suggestions by certain broadcast commenters,[20] these observations by the Commission were applicable to broadcast programming as a whole, and not to broadcast programming in the context of a

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[17] *Walt Disney at Bear Stearns 17th Annual Media, Entertainment & Information Conference*, FD Wire, March 23, 2004.

[18] *Viacom at Goldman Sach Communacopia XII Conference*, FD Wire, October 2, 2003.

[19] *In the Matter of General Motors Corporation and Hughes Electronics Corporation, Tranferors And The News Corporation Limited, Transferee For Authority to Transfer Control Memorandum Opinion and Order*, 19 FCC Rcd 473, 565 ¶ 202 (2004) (*"News Corp./DirecTV Merger Order")*.

[20] *See, e.g.*, Network Affiliates Reply Comments at 15; Disney Reply Comments at 12-15; Viacom Reply Comments at 7-8; NBC Reply Comments at 5-6.

News Corp./DirecTV combination. Indeed, the Commission stated expressly in the *News Corp./DirecTV Order* that "News Corp. currently possesses significant market power in the DMAs in which it has the ability to negotiate retransmission consent agreements on behalf of its local broadcast television stations."[21]

The FCC has recognized that certain types of programming are critical components of an MVPD's package, and that the absence of such programming would significantly harm a distributor's ability to remain a viable competitor.[22] As Professor Rogerson points out, regardless of whether or not broadcasters can be said to wield market power in a traditional antitrust sense, they do enjoy "market power in the sense that they are able to extract significant compensation from MVPDs in return for providing them with retransmission consent."[23] None of the comments submitted by the broadcasters or their consultants refute the point that broadcast programming is unique, difficult to substitute, and commands a high price.

Comments from Discovery and other non-broadcast MVPD programmers underscore the increased marketplace clout afforded to broadcasters by retransmission consent. Discovery notes that in Manhattan, it is unable to obtain carriage of Animal Planet and the Travel Channel on the expanded Basic tier because over 60 percent of the operator's channel line-up for that tier is broadcaster-affiliated.[24] In comments submitted in another open docket, Court TV observes:

> In a world in which extracting cash compensation from cable operators for retransmission of local broadcast signals was apparently not a realistic

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[21] *News Corp./DirecTV Merger Order* at ¶ 201 (*emphasis supplied*).

[22] *See Program Access Sunset Order* at ¶¶ 34, 47.

[23] Rogerson Reply at 12.

[24] Reply Comments of Discovery Communications, Inc. at 3.

> outcome for broadcasters, as noted above, but in which distribution for new or not fully distributed cable networks was a realistic quid pro quo, it is not surprising that an overwhelming majority of networks gaining distribution have been corporate brethren of broadcast station groups, at the expense of non-broadcast affiliated cable networks. Furthermore, in such an environment, the value of cable networks to media companies with local broadcast groups is higher than it is to anyone else, due to their ability to extract this distribution, as well as to extract more favorable license fees. This has led to the steady consolidation of non-broadcast affiliated cable networks with those companies broadcast groups. This has economically benefited the broadcast companies, at least at the corporate level, through the value created by the new cable networks. However, the consumer has not benefited from improved local over-the-air programming by the broadcasters (these economics were not improved), nor has the consumer benefited from a growth of independent voices in the cable programming space.[25]

Crown Media, owner of the Hallmark Channel, notes that the disparity in leverage between broadcast-affiliated program networks and independent programmers "may cause adverse marketplace consequences, including":

> (a) further difficulty in launching and distributing new services, including video on demand (VOD) and high definition exhibition services, because cable operators forced to divert substantial payments to broadcasters have less to spend on new, independent programming; (b) further restriction of available channel capacity because cable operators forced to carry additional programming consequently may have less bandwidth available for independent programmers; and (c) increased competition in the marketplace for program acquisition with broadcast station groups whose revenues effectively are subsidized by government regulations. Finally, for cable subscribers, it appears that the only effects of these regulations are likely to be increased cable rates and decreased programming diversity.[26]

In short, while the broadcast commenters attempt to minimize the leverage afforded to them by retransmission consent, their efforts are belied by statements from

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[25] *In the Matter of Petition for Rulemaking to Amend 47 C.F.R. §§ 76.64, 76.93, and 76.103 Retransmission Consent, Network Non-Duplication, and Syndicated Exclusivity*, RM-11203 ("*ACA Petition for Rulemaking*"), Comments of CourtTV, at 4 (Apr. 18, 2005).

[26] *ACA Petition for Rulemaking*, Comments of Crown Media at 3-4.

broadcast executives themselves, their competitors, the Commission, and basic economic theory. The evidence in the marketplace and the record in this proceeding make clear that retransmission consent has provided the broadcast networks with the means and ability to use their control over scarce spectrum to obtain pricing leverage and bargaining strength in the multichannel video programming market.

## II. BROADCASTERS HAVE FAILED TO SHOW HOW RETRANSMISSION CONSENT HAS HELPED FULFILL THE CONGRESSIONAL OBJECTIVE OF STRENGTHENING FREE, OVER-THE-AIR TELEVISION AS A VIABLE COMPETITIVE ALTERNATIVE TO CABLE

There is no indication that Congress' goal in adapting retransmission consent was to enable the Big Four networks to become the dominant MVPD programmers. To the contrary, the language and legislative history of the 1992 Cable Act make clear that the key objectives of retransmission consent were to strengthen free, over-the-air local broadcast programming and to foster more competition -- not cross-ownership -- between the cable and broadcast businesses. The broadcaster filings provide no evidence to show that retransmission consent has succeeded in preserving or strengthening the ability of over-the-air broadcasting to provide consumers with a competitive alternative to cable.[27]

ABC/Disney's recent deal with the National Football League (NFL) -- in which it paid $1.1 billion to switch Monday Night Football from its over-the-air broadcast network to ESPN -- underscores the degree the Big Four consider broadcast channels and cable networks fungible programming assets.[28] As Professor Rogerson notes, the

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[27] Joint Cable Comments at 31-36.

[28] "Monday Nights Are Changing: NFL off ABC," *New York Times*, April 19, 2005 ("Renewing 'Monday Night Football' did not make financial sense for ABC," said George Bodenheimer, president of ABC Sports and ESPN, "but it made great financial sense for ESPN").

"migration of ABC's Monday Night Football to ESPN is another . . . example where broadcasters are apparently much more enthusiastic about investing in programming to be shown over their MVPD networks than in programming to be shown over their broadcast networks."[29] NFL programming has been dubbed by one industry analyst as the "most valuable television property in the country -- not just the most valuable sports property."[30] The fact that one of the primary beneficiaries of retransmission consent would voluntarily and enthusiastically opt to relinquish Monday Night Football to its MVPD program network affiliate underscores the degree to which the effects of retransmission consent have become unmoored from its purposes.

Lacking evidence that retransmission consent has done anything to enhance the competitive position of local broadcasting vis-à-vis cable or improve the quality of local over-the-air television, broadcast commenters effectively try to rewrite the purposes of retransmission consent. NBC, for example, argues that retransmission consent was designed only to provide broadcasters with "free market" negotiation rights.[31]

Retransmission consent arrangements bear little resemblance to free market negotiations. First, broadcasters primary revenue stream derives from their exclusive control over a public asset -- spectrum -- granted to them for free by the government. For decades they used this exclusive control to build an audience base, brand recognition, asset values, and a mature and still-growing advertising revenue stream. By enacting

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[29] Rogerson Reply at 26-27.

[30] "ESPN Snatches NFL on Monday," *Wall St. Journal*, April 19, 2005, at B1.

[31] NBC Reply Comments at 2-3. As a threshold matter, it was by no means a universally held view among the members of Congress that considered the 1992 Cable Act that retransmission consent represented a restoration of free market rights. Senator Orrin Hatch (R-UT), for example, considered retransmission consent to be "another regulatory device to control the marketplace."

retransmission consent, the government empowered broadcasters to leverage the threat of withholding access to the scarce public resource they control in exchange for consideration. Second, broadcasters enjoy additional government-granted privileges such as guaranteed carriage by cable and DBS operators, and regulatory enforcement of their exclusive distribution arrangements. Third, cable operators are flatly barred from dropping a broadcast stations during certain times of the year, while broadcasters are empowered to both withhold their signal from MVPDs and restrict the ability of distributors to import a substitute network signal in circumstances where the local affiliate is being withheld. In short, retransmission consent arrangements reflect not so much "the free market itself,"[32] but the numerous regulatory advantages accorded to broadcasters over the last half-century in their putative capacity as stewards of free, over-the-air television.

While some broadcasters attempt to argue that retransmission consent has improved the competitive viability and strength of local, over-the-air broadcasting, they offer little in the way of concrete proof. NAB cites as examples of retransmission consent fulfilling "Congressional objectives to strengthen free over the air television" the launch of three broadcaster-affiliated local cable news channels.[33] The Network Affiliates also cite cable carriage agreements to support the proposition that retransmission consent has enhanced localism, but it is clear that Congress' objective was to strengthen broadcast localism and not cable localism.[34] Fox, meanwhile, proffers a

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[32] *Cf.* NBC Reply Comments at 2-7.

[33] NAB Reply Comments at 14.

[34] Network Affiliates Reply Comments at 40-45.

"trickle-down" theory in which its forays into cable provide it with additional revenues which can be -- but are not necessarily -- used to help its broadcast stations.[35]

These arguments underscore the degree to which the network broadcasters have effectively abandoned using retransmission consent to strengthen local, over-the-air broadcasting as a viable competitive alternative to cable. Instead, network broadcasters have forged a marketplace in which MVPD program networks and broadcast channels are interchangeable assets under their control. Whatever the business merits of such a model, it is not the framework that Congress tried to promote when it adopted retransmission consent.

Broadcast commenters also seek to disparage the significance of dramatic changes in the competitive framework and regulatory landscape since 1992 when Congress originally enacted retransmission consent. Broadcasters do not deny that cable operators face far more competition than they did 12 years ago, while regulatory restrictions imposed upon the broadcasters in 1992 have been eliminated or significantly relaxed. Instead, they argue that such changes have no bearing upon the question of whether retransmission consent policies should be modified.[36]

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[35] Fox Reply Comments at 9-12.

[36] For example, NAB suggests that the fact that only 15 percent of consumers are now dependent upon over-the-air broadcasting as their only source of television -- rather than 40 percent in 1992 -- makes retransmission consent more necessary than in 1992. By NAB's logic, if 0 percent of consumers relied upon over-the-air broadcasting as their sole source of television, Congress would be justified in intervening further in the marketplace to assist broadcasters. A more logical question would be to ask whether a policy which was enacted on behalf of the 40 percent of American households that did not subscribe to cable or DBS, warrants reassessment now that only 1.5 in 10 American households are solely dependent upon over-the-air television as their source of programming. NAB Reply Comments at 4.

The initial comments of the Joint Cable Commenters noted that, since enactment of retransmission consent, the regulatory landscape has improved dramatically for broadcasters, with the relaxation or elimination of numerous rules restricting broadcasters' ability to tap new revenue streams and enter additional lines of business.[37] While the NAB minimizes the import of these changes, the lifting of restraints on broadcasters' ability to tap new revenue streams is relevant to the question of whether it continues to be necessary for the government to confer on broadcasters the benefits of retransmission consent.

Similar questions are raised by the dramatic growth of competition in the MVPD marketplace that has occurred over the last 12 years. While the Network Affiliates attempt to downplay the significance of cable's loss of market share since enactment of retransmission consent,[38] even NAB appears to acknowledge that the emergence of DBS as a strong alternative to cable provides broadcasters with additional leverage.[39] Indeed, one NAB official recently suggested that new competition among cable operators, telephone companies and DBS providers can enable broadcasters to "play one off the other and use that leverage to create a new revenue stream for local TV."[40] Thus, while the broadcasters' pleadings attempt to soft-pedal the significance of changes in the

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[37] Joint Cable Comments at 37-39.

[38] Network Affiliates Reply Comments at 17, 22.

[39] NAB Reply Comments at 18 (noting that new entrants into the MVPD market "could pressure cable operators to finally accede to broadcaster requests for monetary compensation"); *id.* at 31 ("with the recent emergence of DBS as a worthy competitor, as well as the coming outlets that telecommunications companies are creating, broadcasters are able to reap some benefits from a somewhat more competitive market for the sale of retransmission rights").

[40] "Conference Slips Back Into Groove," *Television Week*, April 18, 2005 (quoting NAB spokesman Dennis Wharton).

competitive and regulatory landscape, the record should reflect that the competitive concerns and regulatory restrictions that prompted it to conclude that broadcasters needed strengthening via Congressional intervention are no longer operative.

## III. THE RECORD SHOWS THAT RETRANSMISSION CONSENT HAS BEEN A KEY DRIVER OF CABLE RATE INCREASES

As noted in the initial comments of the Joint Cable Commenters, expanded basic offers consumers a compelling value, providing a diverse array of program channels at a price which, on a per-channel basis, has been largely stable over the last decade. But as we also pointed out, the use of retransmission consent to launch, and broaden carriage of, broadcast-owned MVPD program networks that the Big Four insist on including in cable operators' most popular service tier has been a major fact in shaping the price and composition of the expanded basic package. Thus, to the degree there is a debate about MVPD pricing and packaging, the role of retransmission consent needs to be front and center.

Broadcaster efforts to downplay the role of retransmission consent in fueling cable rate hikes are unpersuasive.[41] For example, Disney notes that the $80 billion spent by cable on capital expenditures in from 1996-2004 is far greater than $10 billion in programming costs it spent last year. Amortized over 12 years,[42] that amounts to $6.7

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[41] *See generally* Rogerson Reply at 16-19. While broadcasters claim that a GAO Report on the cable industry supports their contention that broadcast-owned cable networks do not disproportionately drive cable rate increases, *see, e.g.*, Viacom Reply Comments at 10; Network Affiliate Reply Comments at 23, Professor Rogerson demonstrates that the GAO Report cannot be relied upon as evidence for that assertion. Rogerson Reply at 14-15.

[42] Twelve years represents a typical capital investment recovery period for a cable operator filing for a Form 1235 network upgrade surcharge, which is used by some regulated cable operators to compute the proper amount of capital costs associated with upgrading to 750 MHz that should be apportioned to Basic service tier subscribers.

billion a year on capital expenditures, or 33 percent less than the amount of 2004 programming costs identified by Disney.

The Network Affiliates try the opposite tack from Disney, asserting that programming costs account for only $11.83 (29 percent) of the $41.04 cost of expanded basic, suggesting that this somehow constitutes "a substantial mark-up."[43] While the Network Affiliates may obtain their programming distribution infrastructure from the government for free, cable operators were required to spend billions of dollars to erect and maintain a distribution network, as well as the expenses associated with operating customer call centers, developing a subscriber billing and collection infrastructure, maintaining customer premises equipment, installation, and service call personnel and facilities, or paying local governments recurring fees for the privilege of using public rights-of-way to deliver their programming.

The Network Affiliates' implication that having program costs account for nearly one-third of an MVPD's retail revenue is somehow not very significant, may reflect the fact that the Network Affiliates' members pay little or nothing for the network programming which they exhibit. More importantly, there is no merit to the suggestion that an increase in a significant component of cable prices -- programming costs -- should be disregarded because cable prices have other components as well. As Professor Rogerson states:

> As I understand the argument, the studies are attempting to argue that whether or not the price increases caused by retransmission consent are of a significant dollar magnitude is unimportant so long as they represent a small share of the total increases in cable subscription prices that have occurred. This makes no sense. If retransmission consent has caused MVPD subscription prices to increase by a significant dollar magnitude,

[43] Network Affiliates Reply Comments at 24-25.

> this is a serious problem that the Commission should address regardless of whether or not other factors have also caused additional increases in cable subscription prices.[44]

Elsewhere in their Reply Comments, the Network Affiliates appear to confirm that broadcasters are extracting substantial revenue via retransmission consent negotiations,[45] but argues that "there is nothing to suggest that MVPDs are paying an unreasonable or unfair price" for broadcast programming.[46] As noted above, the Joint Cable Commenters believe that expanded basic represents a good value for consumers, but to the extent that there are concerns about the size and price of that package, policy-makers need to be aware of the role played by retransmission consent. The Network Affiliates' observations confirm that role.

Viacom argues that the \$2.56 monthly per subscriber increase over the last seven years spent by MVPDs on new program networks identified as being launched due to retransmission consent tie-ins is far lower than the overall \$14.98 total increase for expanded basic.[47] As a threshold matter, if those are networks that would not be carried on expanded basic by operators absent retransmission consent, then rates rose an additional 17 percent due to retransmission consent.[48] It is unlikely that Congress or

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[44] Rogerson Reply at 16.

[45] Network Affiliates Reply Comments at 26 (suggesting that, based on Disney's "low-end" estimate, "the monthly license fee for a complement of the four networks would be \$8.00 - \$8.36" and that "this total license fee is right in line with monthly license fees of the network-owned cable channels," thereby showing that MVPD subscribers "are not being gouged" by the broadcast networks).

[46] *Id.*

[47] Viacom Reply Comments at 9-10. *See also* Rogerson at 34, table 9 (listing 27 Big Four-owned cable networks identified by ACA whose launch was a result of retransmission consent tie-ins).

[48] *See* Rogerson Reply at 17 ("A social cost of \$2.56 per subscriber per month is a significant dollar magnitude in and of itself").

consumers would consider that trivial. Further, those networks' rates increased 130 percent during the seven-year time period, while overall rates rose 57 percent,[49] thereby confirming the Joint Cable Commenters' observation that broadcast-affiliated cable networks launched as a result of retransmission consent are contributing disproportionately to cable rate increases.

To be sure, a number of factors go into expanded basic cable pricing -- but if the price of programming had gone up with inflation, expanded basic price increases would have been significantly smaller. The chart below compares the growth in license fees for the 40 most widely carried MVPD program networks with the rate of inflation over the last seven years. As the chart indicates, license fees associated with the 25 broadcaster-owned MVPD program networks including in the top 40 rose more than 6 times faster than the rate of inflation during this period. Had programming costs for the top 40 MVPD program networks simply risen level with the rate of inflation from 1997-2004, cable rate increases would have been nearly one-third lower during this period.

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[49] *See* "Response to Comments Regarding Economic Consequences of Retransmission Consent," attached to Viacom Reply Comments, at 10-11 (noting rise in retrans cable networks from $1.11 in 1997 to $3.67 in 2004); Joint Cable Comments at Table H (noting rise in expanded basic price from $26.06 to $41.04).

**Summary: Comparison of Fee Increases**
**For 40 Most Widely Carried Video Networks**
**1997-2004**
**Actual vs. CPI Index**

| | 1997 Total License Fees ($) | 2004 Total License Fees ($) | % Change | Gross Change ($) |
|---|---|---|---|---|
| **Broadcaster-affiliated networks** | 4.53 | 8.70 | 92.1% | 4.17 |
| *Fees indexed to CPI* | 4.53 | 5.19 | 14.5% | 0.66 |
| **Non-broadcaster affiliated networks** | 2.10 | 3.13 | 49.0% | 1.03 |
| *Fees indexed to CPI* | 2.10 | 2.40 | 14.5% | 0.30 |
| **Total fees** | 6.63 | 11.83 | 78.4% | 5.20 |
| *Total fees indexed to CPI* | 6.63 | 7.59 | 14.5% | 0.96 |

Source: Kagan, *Economics of Basic Cable Networks* (2003) at 53-54; Kagan, *Economics of Basic Cable Networks* (2005) at 33-34, 50-52, section 11.
FCC Cable Pricing Report (2005), Docket No. 05-12, at 20.

## CONCLUSION

The record established here compels the Commission to include in its Report to Congress a realistic assessment of the social costs of retransmission consent, including the costs to consumers.

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May 23, 2005

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